U. S. Securities and Exchange Commission
Washington, D.C. 20549 (202) 272-2650

News Release

THE NEW TRANSFER AGENT:
PAST PROGRESS, FUTURE PROSPECTS

Remarks to

The Stock Transfer Association, Inc.
1985 Annual Meeting
and Conference Program

Camelback Inn
Scottsdale, Arizona

October 25, 1985

Charles C. Cox
Commissioner
Securities and Exchange Commission
Washington, D. C. 20549

The views expressed herein are those of Commissioner Cox and do not necessarily represent those of the Commission, other Commissioners or the staff.

In these past fifty-one years of federal securities regulation, the SEC has seen some novel types of securities. From ordinary stocks and bonds came the modern variations of "mixed" debt and equity debentures, and we now have zeroes, strips, CATS, CARS and many types of physical securities, such as orange groves, mink farms, and milk culture cosmetics. But consider for a moment the historical development of our most basic security -- money.

In the past two centuries, our experience with currency has undergone dramatic changes. First, of course, the paper currency actually represented gold owned by the United States. Your dollar bill was in effect a receipt or claim for a certain weight -- a dollar's worth -- of gold. Soon, there were more dollar bills than gold reserves, but the currency was still called a "demand note." Then, of course, the dollar bill didn't represent anything at all -- it was itself a dollar. With the advent of large-scale commercial operations, we went a step further and began using checks, drafts, and other things that only represented a claim to a certain amount of paper money. And today, electronic fund transfers have made even checks and drafts obsolete. Our currency is often represented only by an account, and our wealth is changed by moving numbers representing drafts or checks representing paper money, which used to represent gold. Multimillion dollar transactions consummated by computer entry are commonplace today.

I believe the development of the use of money is a story that should not be lost on those of us who deal with securities and other more complex forms of wealth, because similar changes are occurring in our industry every day. The modern pace of commerce requires adaptation by people like yourselves who keep track of changes in wealth and its transfer from one person to another. Technological advances that make pure book-entry systems and the immobilization of securities inevitable challenge the stock transfer agent industry and call upon you to creatively anticipate the changing environment. What you decide to do will directly alter the fate of the transfer agent and will undoubtedly change the settlement and clearing process for securities in the future.

Overview: The Transfer Agent in 1985

Turning back from currency to more familiar ground, I'd like to briefly continue my historical sketching. In the "paperwork crisis" of the late 1960's, we realized that inefficiency in the clearing and settlement process can have devastating effects on the nation's capital markets. The Commission was given broad regulatory authority over transfer agents in 1975 to prevent the recurrence of such a crisis and to maintain prompt, accurate and safe settlement of securities transactions. 1/

1/ *See* Securities Exchange Act Section 17A(a)(1), part of the legislation adopted in 1975, stating Congress' findings that:

(Footnote continued)

The change since 1969 has been truly revolutionary. We estimate that the number of stock certificates transferred may have been cut by as much as 75 percent from 1969 to 1984. 2/ During this same period, the number of account holders doubled, and the number of shares traded on the New York Stock Exchange increased over fifteen-fold. These changes are due in no small part to the efforts of transfer agents. You should be rightfully proud of the revolution you have so skillfully directed. The national system for the clearance and settlement of securities transactions has been automated to comfortably accommodate trading days in excess of 100 million shares.

However, the revolution continues, with the past as prologue. These changes I just described are almost taken for granted today. In fiscal 1984, over 28 billion equity shares were traded on all exchanges -- five times the volume at the height of the "paperwork crisis." An additional fifteen billion shares were traded over-the-counter in 1984, double the 1982 figure. And thousands of new registration statements are declared effective by the Commission each year, pouring new bonds and shares into this swelling stream of securities. In 1984, we estimate that well over ten million equity certificates in national-interest issues alone were handled by transfer agents, and many millions more certificates for other products, such as municipals, governments, and private notes.

1/ (Footnote continued)

(A) The prompt and accurate clearance and settlement of securities transactions, including the transfer of record ownership and the safeguarding of securities and funds related thereto, are necessary for the protection of investors and persons facilitating transactions by and acting on behalf of investors.

(B) Inefficient procedures for clearance and settlement impose unnecessary costs on investors and persons facilitating transactions by and acting on behalf of investors.

(C) New data processing and communications techniques create the opportunity for more efficient, effective, and safe procedures for clearance and settlement.

(D) The linking of all clearance and settlement facilities and the development of uniform standards and procedures for clearance and settlement will reduce unnecessary costs and increase the protection of investors and persons facilitating transactions by and acting on behalf of investors.

2/ Unless, otherwise indicated, all statistics cited were prepared by Commission staff members. Many of these statistics will be in the Commission's 1985 Annual Report.

Today, transfer agents play an integral role in the national system for the settlement of securities transactions. You are responsible for cancelling old securities certificates; issuing new certificates; recording changes of record ownership; handling dividend and interest payments; providing prompt, safe and accurate clearance and settlement of transactions during tender offers; and, in conjunction with disseminating various security-holder communications, tabulating votes from solicited proxies.

This pretty well describes the past and present, but what of the future transfer agent? I believe current changes in the securities market as well as in the marketing of securities reflect new consumer preferences. It is a classical example of supply-and-demand market adjustment at work. The changes in the securities transfer industry are an evolution that is an expression of market forces. I believe the job of any regulator -- the SEC included -- is to allow those market forces to operate unimpeded. The translation of consumer preferences into industry structure should not be artificially enhanced, nor should it be needlessly inhibited.

Contrary to what some of you may anticipate, I am not here to deliver a discourse on the transfer agent as an endangered species. Rather, I am here to advise you to focus on the transfer agent's long range viability in this changing market. I believe that the power to determine the future very definitely rests in your hands. It's up to you to ensure that the necessary steps are taken today to guarantee your presence in the field tomorrow.

This morning, I'm going to focus on several initiatives in the continuing evolution of the National Securities Clearance and Settlement System. Those areas include the Depository Immobilization of Securities and the use of electronic book-entry systems. I don't think we'll see the end of the stock certificate in our lifetime, but we will continue to see a decline in its presence in the back offices and on the sidewalks of Wall Street. In addition, I will briefly discuss some other areas which will be of interest in your future planning: the Commission's new shareholder communications rules, developments in the marketing of treasury securities, and a review of the Commission's enforcement program involving transfer agents.

<u>The National Clearance and Settlement System</u>

The National Clearance and Settlement System currently permits broker-dealers and banks to immobilize and thereby safekeep securities certificates in centralized securities depositories and to settle securities transactions by computerized book-entry. Despite the proliferation of deposits in the national system, nearly half of the dollar value of corporate equity securities certificates listed on the NYSE remains outside of the system. 3/

3/ Division of Market Regulation, Securities and Exchange Commission, <u>Progress and Prospects: Depository Immobilization of Securities and Use of Book Entry Systems</u> 4 (Draft, June 14, 1985) (hereinafter <u>Draft Report</u>).

Continued immobilization of institutional securities holdings can make our securities processing more cost effective, save time by eliminating unnecessary steps, and significantly reduce the risk of lost and stolen securities.

The current initiatives in this area are outlined in the SEC's Staff Report on Depository Immobilization of Securities and Use of Book-Entry Systems. 4/ The staff in our Division of Market Regulation tells me that the STA and several STA members have provided detailed constructive comments on this Draft Report. I take this as evidence of a commendable willingness on the part of many transfer agents to work for organized, deliberate and beneficial change in our marketing of securities.

As I suggested at the outset, the Commission shares this philosophy, and we greatly appreciate your cooperation. The Commission does not intend to make any drastic changes in immobilization in the near future. Instead, we have adopted a program, as reflected in the Draft Report, of presenting our ideas to encourage innovation and focus public and industry discussion instead of mandatory regulation. The necessary consequence of this is that, while the Commission will not mandate change, neither will it inhibit change. My staff informs me that transfer agents generally view the advent of global certificates, and even issuer book-entry systems to a lesser extent, with the same glee and excitment which the New York Stock Exchange has exhibited toward the idea of removing off-board trading restrictions. However, your concerns and the NYSE's have one thing in common -- they will not go away if ignored.

To ensure that there is no confusion as to the terminology that I will be using today, I'm going to take a moment to distinguish the various systems. In an immobilized or global certificate system, certificates reflecting ownership interest are still used, but ownership is centralized by using the securities depository as the single nominee of its participant brokers, banks and their customers. In a certificateless or book-entry system, there is no negotiable certificate, and all transfers are made in reliance on computerized records of the issuer or transfer agent. The certificateless system presumably also permits centralized ownership through nominees. 5/

The Draft Report addresses means of expanding the use of central depositories in an effort to immobilize securities certificates and reviews current developments involving book-entry systems. Following are six areas in which I believe the greatest progress can be made in the securities immobilization program.

4/ See note 3 supra.

5/ See Draft Report at 2-3 and Appendix A.

First, I'd like to discuss the most controversial of reforms -- the use of global certificates. Although the Commission is sensitive to the concerns expressed by the STA and others, we have encouraged corporate and municipal issuers and their underwriters to experiment with the use of global certificates for public and private debt offerings. Chairman Shad has sent letters discussing global certificates to banks, brokers and large issuers, and has met with several large investment bankers. An ad hoc committee of major investment bankers has been formed to study the use of global certificates and their impact on underwriting and distribution costs. It would be currently feasible to expand the use of global certificates in debt offerings, as they have few of the problems of equity offerings. They involve discrete, new issues so there are no existing holders of certificates to contend with. Debt securities also do not present the same security holder communication problems as equity securities. Although I recognize that the prospect of full immobilization through global certificates may come as somewhat of a threat to many of you here today, from a legal and economic perspective, global issues provide safe, efficient and inexpensive alternatives to other forms of securities issuance.

The Draft Report estimates that depository immobilization can reduce the cost of processing each trade by at least ten dollars. 6/ In addition to the processing savings, global certificates provide benefits to underwriters, broker-dealers and custodians in the form of faster turnaround time on deliveries to customers, which translates into reduced financing costs, a reduced risk of loss, and an elimination of multiple handling of certificates among syndicate members. Clearly, the safekeeping benefits are significant in a system that requires little, if any, vault space and no administrative handling of certificates by depository personnel.

Global certificates have been used for other securities as well. As of September 1985, twelve states and 21 local jurisdictions have issued debt offerings in global certificate form. The states range in size from California to Delaware, and the local jurisdictions range from metropolitan areas such as Philadelphia and Albuquerque to Elko and Humboldt Counties in Nevada and Carbon County, Utah.

The second area in which I believe great progress can be made is insurance restrictions. Some state laws limit voluntary use of depository facilities by placing various custody restrictions on insurance companies and public retirement systems. An effort should be made to encourage states to ease some of the restrictions on depository custody of insurance company securities portfolios. In response to suggestions by the SEC, the National Association of Insurance Commissioners has established an ad hoc committee to work in concert with other interested groups to minimize or eliminate such regulatory restrictions. This committee has sent letters to each of the states with restrictive laws, and Chairman Shad has written follow-up letters on behalf of the SEC.

6/ Draft Report at 6-7.

Third, the Commission has stressed increased immobilization through SRO enforcement of rules requiring institutional trade settlement through automated depository facilities. In this way, the institutional investors, money managers, banks and brokers are brought together, and the cumbersome affirmation process can be collapsed from weeks to days. The actual transfer of securities and cash can be accomplished in many cases by settlement date, thus reducing or eliminating broker financing costs. In addition, the Commission encourages further public discussion of the costs and benefits of immobilizing institutional securities portfolios.

Fourth, the current depository immobilization can be made more efficient on a nationwide basis. This can be accomplished by expanding the use of automated links between depositories and transfer agents, by actively seeking comprehensive use of transfer agent custodian programs, and by expanding broker and bank use of depository programs that would enable transfer agents to mail certificates directly to customers.

The Transfer Agent Custodian Program, or "TAC" program, reduces the number of certificates in the depository's vault and allows transfers by brokers and banks to be automated on a same day basis. This can be accomplished because the transfer agent will retain at least one "balance" certificate reflecting the depository's position in a particular issue.

Under the direct mail programs, the depository receives requests from its participants, consolidates them, and forwards the instructions to the transfer agent. Pursuant to the participants' instructions, the transfer agent mails the certificate directly to the customer.

Fifth, in states where permitted by law, issuers might consider selling uncertificated securities through carefully monitored issuer-run or agent-run book-entry systems. Only fourteen states have adopted the 1977 Amendments to the Uniform Commercial Code that deal with uncertificated securities. Because many consider uniform adoption of those amendments to be essential to nationwide experimentation with uncertificated securities, we plan to help coordinate efforts towards uniform state laws in this area. Commission staff members have met with representatives from the American Bar Association and their committee working on this part of the UCC, and with state bar associations in some of the 36 states which have not adopted these amendments. The staff has also been working with the IBM Corporation in its planned modified single certificate debt offering that increases transfer agent involvement, maintains shareholder accounts, reduces the number of certificates issued and tests the waters for future uncertificated offerings. Efficient streetside clearance and settlement can be maintained through interfaces between IBM's trustee and the securities depositories.

Sixth, as indicated in the staff report, immediate attention should be given to immobilizing Ginnie Mae pass-through securities. A couple of months ago, Ginnie Mae expressed support for a private securities depository initiative. I understand that discussions are now underway to expand that depository from its limited pilot phase, although to date the trading remains highly certificated. I want to emphasize the potential for another paperwork crisis in these markets if physical certificate processing continues to be the accepted mode of settlement. The staff estimates that, as of year-end 1984, 40 billion dollars worth of Ginnie Mae securities were settled each month, in approximately 21 thousand trades. Since settlement occurs but once a month in this market, continued high volume can only be accommodated through immobilization and automated, centralized processing. 7/

These developments are not, of course, the sole responsibility of the Securities and Exchange Commission. I have mentioned that states should be encouraged to change laws governing custodial arrangements and the perfection of security interests. And in February 1985, the Department of the Treasury announced its plans to offer issues of its marketable bonds and notes exclusively under a certificateless book-entry system. The Treasury expects to have full book-entry in place by mid-1986. It anticipates that investors will establish book-entry bond and note accounts directly with the Treasury in much the same way as they now do for Treasury bills. Under no circumstances will engraved certificates be available for new issues of marketable bonds and notes. 8/

I find especially intriguing another idea, which was suggested at our Roundtable on Major Issues held in Washington in September: that some of the issuer cost savings in this area be shared with investors, in order to increase the incentive to forego certificates. Alternatively, issuers could charge those persons who want their own certificates for the incremental issuance and transfer costs. This may accelerate the trend, noted by the Roundtable participants, of a declining preference for individual certificates.

Other Areas of Interest

Although I have indicated that immobilization is probably the biggest challenge facing future transfer agents, there have been developments in related areas which are worthy of mention. One such area is shareholder communications. Increased immobilization of equity certificates would reduce direct contact between issuers and beneficial owners. These parties will have to depend more on intermediaries to process and deliver issuer reports, requests for proxies, and other shareholder communications. Earlier this month, the Commission adopted new Rule 14a-13 and

---

7/ *See generally* *Draft Report* at 35-43.

8/ *Treasury News* B-24 (Feb. 22, 1985).

modifications to Rule 14b-1(c) under the Securities Exchange Act of 1934 in an effort to improve communication between issuers and beneficial owners whose shares are held in the names of broker-dealers. 9/ The system takes effect on January first, 1986. The new rules provide that:

- an issuer who requests a shareholder list from one broker must do so from all brokers.
- an issuer may request shareholder lists as often as desired; however, brokers must be reimbursed for their reasonable expenses.
- an issuer may mail its annual reports directly to beneficial owners, but proxy materials and other communications must be sent indirectly.

Further, the new rules contemplate that intermediaries could be used to compile shareholder lists from brokers and standardize those lists. Brokers may satisfy their obligations under the new rules through use of such an intermediary. 10/

The proposed changes drew over 40 letters of comment, ten of which were from brokers, transfer agents, or related groups. The three main concerns of the commentators were:

- that some issuers might engage in so-called "cherry-picking" -- requesting shareholder lists from some brokers but not others;
- that intermediaries be approved for brokers to use in meeting the rules requirements;
- that similar obligations be imposed on banks, in order to "close the regulatory gap." 11/

The rules as adopted have addressed the first two concerns. In response to the third, the Commission has recommended legislation. The Shareholder Communications Act of 1985, if enacted, would authorize the Commission to regulate proxy distribution and voting of shares held for beneficial owners by banks, associations and other entities exercising their fiduciary powers. The bill was passed by the House on July 22, 1985 and is now under review by the Senate. The Commission has been diligent in its support for the bill. Chairman Shad wrote last month to Senators Garn and D'Amato, urging prompt action by the Senate on the bill.

9/ Securities Exchange Act Release No. 22533 (Oct. 15, 1985).

10/ *Id*. at 10-12.

11/ *See* Summary of Comments, Proposed Amendments to the Shareholder Communications Rules (File No. S7-13-85, available for inspection in the Commission's Public Reference Room).

So far, I have reviewed new developments in the transfer agent industry. Turning to the Commission's enforcement program, however, I would note that certain old-fashioned ways of making money may still prevail. Earlier this month the Commission obtained a preliminary injunction and a temporary freeze of assets in a case involving Securities Transfer, Incorporated. According to the Commission's allegations, stock certificates representing millions of dollars worth of securities were fraudulently issued by one individual at Securities Transfer, and were subsequently used in connection with the borrowing of funds. 12/ The staff has suggested this may be the largest fraud case ever brought by the SEC involving a transfer agent. 13/

Earlier this year, the Commission obtained the latest in a series of injunctions growing out of an action filed against the American Registrar and Transfer Company in 1983. The Commission alleged that the transfer agent redeemed unregistered and restricted shares, removed the restrictive legend, and reissued those shares to the public in violation of the registration requirements of the Securities Act of 1933. 14/ The Commission in March revoked the registration of the Bountiful Registrar and Transfer Company of Bountiful, Utah. The Commission found that in 1982 Bountiful surrendered virtually all the securities and records of one company back to the issuer and continued to act as the issuer's transfer agent, and never obtained an agreement that the issuer would maintain those records, as required by Rule 17Ad-7 under the Securities Exchange Act of 1934. 15/ And in July, the Commission by consent revoked the registration of the Corporate Registrar and Transfer Company, finding that over a two-and-one-half-year period, the company failed the three-day turnaround requirements, and had deficient books and records. 16/

The Commission has also sought legislative expansion of its administrative authority in the transfer agent area. Currently, the Commission has broad authority to sanction broker-dealers,

---

12/ SEC v. Securities Transfer, Inc., No. 85-1049-Civ-Orl (M.D. Fla., Filed Sept. 30, 1985); Litigation Release No. 10905 (Oct. 16, 1985).

13/ Orlando Sentinel, Oct. 11, 1985, p. C-2.

14/ SEC v. Murdock, No. 83-Z-777 (D. Colo., filed May 5, 1983); Litigation Release No. 10717, 32 SEC Docket 1508 (Apr. 3, 1985). See also Litigation Release No. 9991, 27 SEC Docket 1610 (May 6, 1983) (allegations in original filing).

15/ Securities Exchange Act Release No. 21821, 32 SEC Docket 1026 (Mar. 6, 1985).

16/ Securities Exchange Act Release No. 21168, 30 SEC Docket 1496 (July 24, 1984).

municipal securities dealers, investment companies and investment advisers, as well as individuals who are or who seek to become associated with them. However, the Commission has no authority over such "associated persons" in the transfer agent area. Therefore, although the transfer agent's registration was revoked in some of the cases I just discussed, the Commission could not, in an administrative proceeding, prevent the culpable individuals from taking their business and their misconduct to another transfer agent, either already existing or newly created for this purpose. Clearly, this kind of "shell game" hinders effective Commission enforcement. It is a problem recognized in other areas involving securities professionals. Therefore, the Commission has recommended to Congress amendments to Section 17A of the Securities Exchange Act of 1934 which would allow administrative proceedings involving persons associated or seeking to be associated with transfer agents. Pursuant to our recommendation, bills were introduced in the House of Representatives on March 20th and in the Senate on April 16th, 17/ although no further Congressional action has been taken to date.

I certainly do not mean to suggest that these enforcement cases are typical examples of transfer agent activity -- quite the contrary. However, I do want to note that, in an era ushering in profound technological change, the potential for old-fashioned fraud and misconduct remains very real. I believe the Commission should be as vigilant in policing the industry as it is in assuring its orderly and beneficial development.

Conclusion

In conclusion, I believe that this look at the future transfer agent has all the signs of a flattering portrait. You have made great strides -- you are pushing for greater ones still. The Commission's staff is actively involved in discussions with your association's leaders to find solutions to other problems confronting the securities processing community, such as inefficient and outdated signature guarantee processes, and inefficient handling of "legal transfers" by brokers, lawyers and other presenters who often do not know what documents must be supplied to satisfy different state law requirements. Your association continues to provide important and forward-looking leadership. The Commission welcomes its assistance and yours in making this difficult era for transfer agents one of opportunity as well.

17/ The amendment to Section 17A is part of the SEC Technical Amendments Bill, introduced as H.R. 1604 and S. 920.